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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1932.

No. 460.

CHARLES W. ANDERSON, Collector of Internal Revenue for the Third District of New York,
Petitioner,

against

MARIAN STEEDMAN WILSON, ROBERT GOELET and HARLEM G. RUBERT, as Executors of the Estate of RICHARD T. WILSON, JR., deceased,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

RESPONDENTS' BRIEF IN OPPOSITION.

GEORGE E. CLEARY,
CLARK T. BROWN,
Attorneys for Respondents.

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RESPONDENTS' BRIEF IN OPPOSITION.

We have stated our position in this case in our cross petition and brief in support thereof and have there stated the facts and the nature of the controversy (No. 461).

We do not believe the case is one in which a writ of certiorari should be granted. We have asked that if a

writ of certiorari is granted on the petition of the Solicitor General a writ be granted on the cross petition and the whole case presented to the Court and the Solicitor General consents to this. (See Memorandum for the Respondent in No. 461.)

In the petition for certiorari of the Solicitor General and the brief in support thereof, it is not claimed that the decision below is in direct conflict with decisions in other Circuits but it is urged that a writ of certiorari should be granted on the ground that the decision below, in allowing a deduction to a beneficiary of any part of the loss on the sale of trust assets, conflicts *in principle* with *Abell* v. *Tait*, 30 F. (2d) 54 (C. C. A. 4th, certiorari denied 279 U. S. 879) and *Baltzell* v. *Mitchell*, 3 F. (2d) 428 (C. C. A. 1st, certiorari denied 268 U. S. 690). But in those cases the facts were essentially different from the facts in the present case and there is no conflict in principle.

In those cases, beneficiaries entitled to receive the *income* for life, and who had no interest, or, at the most, a very contingent interest, in the *corpus* of a trust were required to pay income tax on the entire amount distributed to them as income, without reduction because of losses sustained on the sale of part of the corpus of the trust. The *principle of those cases* is that the beneficiaries, *having no direct interest in the corpus of the trust*, and receiving income not affected in amount by losses or gains on sales of trust assets, were not entitled to reduce the income actually received by reason of losses on the sale of trust assets. Thus, in *Baltzell* v. *Mitchell*, *supra*, the Court said:

> "The beneficiary is not interested in the capital of the trust, but only in the income. If there are accretions to the capital, these are not distributable as income, so that the beneficiary may receive any part of them; and if there are capi-

> tal losses they cannot be made good out of the income. The capital may be depleted by such losses; but the income for that taxable year is not. It may in future years be diminished because of the diminution of the capital."

In *Abell* v. *Tait*, the Court said:

> "The amount actually distributed to the beneficiaries could not have included any part of the capital of the trust estate for any such distribution would have been contrary to the express provisions of the trust."

In the present case, the beneficiaries, unlike the beneficiaries in *Baltzell* v. *Mitchell* and *Abell* v. *Tait*, were directly interested in the capital of the trust. In fact, the beneficiaries had every present and future interest in the trust property and its income. They were not merely life tenants or tenants for years. Accretions to the property belonged to the beneficiaries and were distributable to them. Unlike *Abell* v. *Tait*, the amount actually distributed to the beneficiaries could and did include distributions of corpus.

In the other cases cited by the Solicitor General (1) it is admitted that "with the exception of the Kaufmann case [*Kaufmann* v. *Commissioner*, 44 F. (2d) 144 (C. C. A. 3rd)] it did not appear that the particular beneficiary would be entitled at any time to receive distributions of corpus * * *", (Brief in support of petition, Page 15). In the Kaufmann case the residuary estate was devised to the widow of the testator for life with the privilege of using as much of the principal

(1) *Mary Roxburghe*, 64 C. Cls. 223, certiorari denied, 278 U. S. 598; *Whitcomb* v. *Blair*, 25 F. (2d) 528 (App. D. C.); *Codman* v. *Miles*, 28 F. (2d) 823 (C. C. A. 4th), certiorari denied, 278 U. S. 654; *Hubbell* v. *Burnet*, 46 F. (2d) 446 (C. C. A 8th), certiorari denied, 283 U. S. 840; *Codman* v. *Commissioner*, 50 F. (2d) 763 (C. C. A. 1st); *Roxburghe* v. *Burnet*, 58 F. (2d) 693, certiorari denied, 286 U. S. 567. See also *Kaufmann* v. *Commissioner*, 44 F. (2d) 144 (C. C. A. 3d).

as she chose from time to time with remainder over to the testator's sons. The widow, in 1907, long prior to the taxable year in question, had made a valid gift of all her interest in the estate to the sons except the income from the real estate and her separate property. After 1907, therefore, the widow had no interest in the estate property except the right to get the income from the real estate for life. The Circuit Court of Appeals denied her a deduction for depreciation on such property, saying "The loss due to depreciation must fall upon the remaindermen". In the present case, however the beneficiaries were not only entitled to the income but *were the remaindermen, and were entitled to distributions of corpus.*

The distinction between the cases relied upon by the Solicitor General and the present case is clearly pointed out in *Merle-Smith* v. *Commissioner*, 42 F. (2d) 837 (C. C. A. 2nd, certiorari denied 282 U. S. 897). In that case, beneficiaries who had a real interest in the corpus (although not as direct and complete an interest as the beneficiaries in the present case) were allowed a deduction for depletion of the trust property. The Court distinguished *Baltzell* v. *Mitchell* as follows:

> "In the Baltzell case, supra, Mrs. Baltzell had 'a vested equitable remainder,' which was a power to dispose of the property by her will; she had no legal remainder. At bar, the trust is not for life, for it ends at the forty-fifth birthday of the petitioner Kate Fowler Merle-Smith. Margaret Fowler's ceases at the same time or sooner in the event of the death of Kate Fowler Merle-Smith. *The petitioner here has the real interest in the corpus. She possesses every important attribute of ownership.* She has a 75 per cent. interest in the income, and she suffers most by the depletion. Apart from the payments to others of a 25 per cent. interest while they live

> during the period of the trust, she is in the position of one having others manage her property." (Italics supplied.)

The Court also distinguished *Roxburghe* v. *United States*, 64 Ct. Cl. 223, cited by the Solicitor General, as follows:

> "In *Roxburghe* v. *United States*, 64 Ct. Cl. 223, the plaintiff was merely a beneficiary entitled only to income of the trust created for her life. She had no interest in the corpus."

The distinction between cases of beneficiaries entitled only to income for life and those of beneficiaries who have a direct interest in the corpus is also recognized and specifically referred to in *Codman* v. *Miles*, *supra*, and *Roxburghe* v. *Burnet*, *supra*.

The decision below, therefore, does not conflict in principle with the decisions in *Baltzell* v. *Mitchell*, *supra*, and *Abell* v. *Tait*, *supra*, and is consistent in principle with the *Merle-Smith* case.

The Solicitor General dismisses the *Merle-Smith* case with the statement that "the depletion provision merely authorizes reasonable allowance for depletion without providing to whom it shall be allowed" (p. 8 of petition). But the section providing for deductions by individuals (Section 214 (a) Revenue Act of 1921) does not specifically provide to whom any of the deductions shall be allowed. Obviously depletion is allowable as a deduction only to one who has an ownership in the property. Certainly it would not be admitted that a stranger to the property would be entitled to a deduction for depletion. The allowance is based on *ownership*, and the principle of the *Merle-Smith* case is that the allowance is to be made to the real owner of the property, even though the property may technically be

held in trust. In *Cooper* v. *Reynolds*, 60 Fed. (2d) 650 (D. C. Wyoming), it was held on the authority of the *Merle-Smith* case that the beneficiaries of a trust were entitled to deductions for depletion of the corpus. The Court said:

> "As I view the situation here presented, *the determining factor* in the matter of the validity of the tax *is as to whether the plaintiffs as beneficiaries under said trust have or have not an interest in the corpus covered by the trust.* If they have such an interest, the depletion is properly deductible and the tax is improperly assessed; while on the contrary, if they have no interest in such corpus, the depletion charged is not deductible and the taxes are proper." (Italics supplied.)

In the present case, the beneficiaries were even more clearly the real owners of the property than the beneficiaries in the *Merle-Smith* case. The loss on the sale of the trust property was in fact their loss, and, we submit, was deductible by them.

The Solicitor General urges as a further reason for granting a writ of certiorari that the decision disregards the familiar principle stated in *Burnet* v. *Thompson Oil & Gas Company*, 283 U. S. 301, and other cases, that no deduction may be allowed unless specific authority therefor is found in the statute. Section 214(a) of the Revenue Act of 1921 provides:

> "That in computing net income there shall be allowed as deductions:
>
> "* * *
>
> "(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;
>
> "(5) Losses sustained during the taxable year and not compensated for by insurance or other-

wise, if incurred in any transaction entered into for profit, though not connected with the trade or business;"

That losses are allowable on the sale or other disposition of income producing property, acquired by inheritance, is clearly recognized by the Revenue Act of 1921 and the other Revenue Acts, which specifically provide the "basis" for the determination of gain or loss on the sale of inherited property. (Section 202(a) (3) of the Revenue Act of 1921). In *Brewster* v. *Gage*, 280 U. S. 327 (1930), this Court, in determining when inherited property was "acquired", for the purpose of determining gain or loss, assumed that a loss on the sale of inherited property was an allowable deduction and no contention to the contrary seems to have been made.

The Solicitor General contends that the question in this case is one of general importance. The primary question in the case is whether or not the will of Richard T. Wilson, Sr. created any trust of his residuary real estate. If no such trust was created, then the questions raised by the petition of the Solicitor General do not arise. The Solicitor General contends that the Court below correctly construed the will of Richard T. Wilson, Sr. as creating trusts in all of his undistributed residuary estate, citing certain New York cases.(2) In some of the cases cited, the provisions of the will were similar in some respects to the provisions of the will of Richard T. Wilson, Sr. But in other cases involving provisions equally comparable it has been held that no trust was created. *Brooklyn Trust Company* v. *Kernan*, 108 Misc. (N. Y.) 452 (1919), unanimously affirmed, 191 App. Div. 895; *Ray* v. *Fowler*, 200 App. Div. 155 (1922).

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(2) *Morse, et al.* v. *Morse*, 85 N. Y. 53; *Marx* v. *McGlynn, Executor, etc., et al*, 88 N. Y. 357; *Ward* v. *Ward*, 105 N. Y. 68; and *Lahey* v. *Kortright*, 132 N. Y. 450.

In almost every case involving the construction of a will, the court must find the intent of the testator under the particular will and under a particular set of facts. No two situations are precisely alike. As was said in *Collister* v. *Fassitt*, 163 N. Y. 281, 286 (1900):

> "It is a trite saying that no will has a brother, and it may also be said that the citation of numerous authorities, in most instances, are of little assistance to the Court, as each will must be construed in the light of peculiar surrounding circumstances, the scheme disclosed, the language employed, and the intention of the testator gathered from the general situation."

The construction of the will of Richard T. Wilson, Sr. of course is not a question of general importance. It is, however, a question which must be decided by the Court before the questions raised by the Solicitor General arise.

In so far as the case involves the deduction of losses on the sale of trust property by beneficiaries having every present and future interest in both the income and corpus of the trust, it certainly is of no greater general importance than was the *Merle-Smith* case, involving a similar problem as to depletion, which this Court refused to review (282 U. S. 897).

The Solicitor General does not discuss the decision of the Circuit Court of Appeals for the Second Circuit in this case, in which it was held that the beneficiaries were entitled to deduct a part of the loss proportionate to the part of the proceeds of the sale distributed to them during the taxable year, the position of the Solicitor General being that no deduction whatever is allowable. While we believe that the entire loss was deductible by the beneficiaries, we submit that they were at least entitled to the deduction allowed by the Circuit Court of Appeals. The taxpayer in this case

should at least be entitled to deduct a loss on the same basis as a profit would have been taxed to him.

Under Sections 219 (a) (4), 219 (c) and 219 (d) of the Revenue Act of 1921, if trust property was sold at a profit and part of the profit retained by the trustees and part distributed, the amount of the profit retained would be taxed to the trustees and the part distributed would be taxed to the beneficiaries. *Appeal of Scripps*, 1 B. T. A. 491; *Barton* v. *Commissioner*, 5 B. T. A. 1008; *Appeal of Sprague*, 8 B. T. A. 173. Where the trust property is sold at a loss, it logically follows that the beneficiaries are entitled to deduct at least that part of the loss proportionate to the part of the proceeds distributed to them within the year. This is consistent with the decision in the *Merle-Smith* case, *supra*, since there the beneficiaries were allowed to deduct the depletion related to the royalties actually distributed to them.

We respectfully submit that the writ of certiorari should be denied on the petition of the Solicitor, and if such writ is so denied, we do not ask for a writ of certiorari on our cross petition. If a writ of certiorari is granted, we request that it be granted on the cross petition as well as on the petition.

Respectfully submitted,

GEORGE E. CLEARY,
CLARK T. BROWN,
Attorneys for Respondents.

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Brief for Marian Steedman Wilson, *et al.*, as Executors of the Estate of Richard T. Wilson, Jr., Deceased.

GEORGE E. CLEARY,
CLARK T. BROWN,
Counsel for Respondents in No. 460 and for Petitioners in No. 461.

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Opinions Below.

The Circuit Court of Appeals reversed the judgment of the District Court with opinion (R. 48) which is reported in 60 F. (2d) 52. The opinion of the District Court (R. 40) is reported in 51 F. (2d) 268.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on July 18, 1932 (R. 53). Both parties filed petitions for writs of certiorari on October 18, 1932. Both petitions were granted on November 21, 1932 (R. 54). The jurisdiction of this court rests upon Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

The case involves the right of Mr. Richard T. Wilson, Jr., now deceased (referred to as the taxpayer), to deduct from his 1922 income all or any part of a loss of $22,660, which was one-fifth of the loss on a sale in 1922 of certain residuary real estate in which the taxpayer and his four brothers and sisters had inherited equal interests under the will of their father, Richard T. Wilson, Sr. The Collector claims that the residuary estate was left in trust and that the loss is deductible only by the Executors as Trustees. The taxpayer claims, (1) even if such real estate was technically held in trust, the five children owned every present and future interest in the property, the income from it and the proceeds of any sales, and the taxpayer was entitled to deduct from his personal income his share of the loss which he actually suffered, notwithstanding the existence of the trust, as the District Court held; (2) under the will of Richard T. Wilson, Sr. this real estate was not in fact devised in trust to his executors and the taxpayer, as the legal and equitable owner of a one-fifth interest in the real estate, was entitled to deduct his share of the loss from his personal income; (3) if the taxpayer is not entitled to deduct the full amount of his loss, he is entitled to deduct

a part of such loss proportionate to the part of the selling price of the property distributed to him by the executors in 1922, as the Circuit Court of Appeals held.

Statutes Involved.

The statutes involved are set forth in the appendix (*infra, pages* 32 to 35).

Statement of the Case.

This suit was instituted in the District Court for the Southern District of New York by Richard T. Wilson, Jr., and upon his death his executors were substituted as plaintiffs (R. 27). The case was decided by the District Court under a stipulation of facts, upon which findings of fact were based. (R. 27-36).

Richard T. Wilson, Sr., the taxpayer's father, died testate in 1910, a resident of New York, leaving a net estate of approximately $16,000,000, of which $2,300,000 was real estate. Under the will (R. 28-32) all of his property was left to his five children, partly in trust, and partly by absolute gift. Prior to 1913 all of the express trusts had been established out of personal property. (R. 34). Prior to 1922 the debts had been paid and all of the estate had been distributed by his executors, partly in cash and partly in securities, except the Commercial Building (a New York office building), other real estate worth approximately $41,000 and personal property worth approximately $150,000 (R. 34-35). In 1922 the executors of the estate of Richard T. Wilson, Sr. were the taxpayer, his brother Marshall Orme Wilson, and the latter's son R. Thornton Wilson (R. 33).

In 1922 the Commercial Building was sold for $165,000 by such executors at an admitted loss of $113,300, based upon its value of $290,000 when inherited and on

March 1, 1913, after deducting depreciation. (R. 35). The record does not show the form in which the consideration was received. Exclusive of this item the executors' income in 1922 was $5.84 less than their expenses (R. 35). The executors distributed $50,000 in cash to the five residuary legatees in 1922 (R. 34) but the record does not show whether or not this sum was all or part of any cash consideration received on the sale of the Commercial Building.

The loss of $22,660 claimed by the taxpayer herein, one of the five children, is one-fifth of the said loss of $113,300.

The Commercial Building was part of the residuary estate passing absolutely to the five children under Article Fourth of the Will (R. 28, fols. 62-63) which reads as follows:

> "All the rest, residue and remainder of my property, real, personal and of every kind and description, which I shall own at the time of my death, I direct my executors, hereinafter named to sell and convert into personalty, and to divide the proceeds thereof into five equal parts which I give and bequeath as follows:
>
> "(1) To my son Marshall Orme Wilson, one of such parts to be his absolutely.
>
> "(2) To my daughter Mary R. Goelet, one of such parts to be hers absolutely.
>
> "(3) One of such parts to the amount of Five Hundred Thousand Dollars I direct to be added to the trust fund of Five hundred thousand dollars created in and by the foregoing Third Article of this will for the benefit of my son Richard T. Wilson, Jr. and to be subject to the provisions of said Third Article both as to the income therefrom and the disposition of the principal thereof, as if a part of said original trust fund; *and the balance of such part I give and bequeath to my said son Richard T. Wilson, Jr. to be his absolutely.*" (Italics supplied).

Sub-paragraphs (4) and (5) of Article Fourth made provisions for two other children identical with those of sub-paragraph (3) for the taxpayer

The Commercial Building was not used in the cases of three of the children, to increase the express trusts created by Article Third which were created out of personal property, (R. 34) but was part of the balance of the residuary estate which passed to the five children to be theirs absolutely.

The will, after providing for the payment of debts and a trust fund for the widow (which never became effective because of her prior death, R. 33, fol. 72), provided in Article Third for five separate trust funds of $500,000 each for the testator's five children, and by Article Fourth three of these were increased by $500,000 each out of the particular beneficiaries' share of the residuary estate, resulting in two trusts of $500,000 each and three trusts of $1,000,000 each, a total of $4,000,000 out of the net estate of $16,000,000. These trust funds were bequeathed to the Union Trust Company of New York as trustee (R. 28, fol. 61-62).

There is no bequest or devise of the residuary estate to the executors. That was to be sold and the proceeds were given absolutely to the five children (except for the additions to the express trusts). There is no indication of any intention to create any trusts other than the express trusts set up with Union Trust Company as trustee. The executors are nowhere in the will referred to as trustees. The Union Trust Company is referred to in Article Sixth as "trustee of the trusts hereinbefore created" (R. 31, fol. 68) and in Article Ninth as "trustee of the trusts under this will." (R. 32, fol. 70).

The will gives the executors certain powers with respect to the residuary estate pending its sale and distribution. It is these powers which give rise to the

question as to whether a trust of the residuary estate must be implied. The provisions are as follows:

> "As the balance of my residuary estate [after the trust funds have been set up] will largely consist of real estate in this and other States and shares of manufacturing and business corporations which should not be sold excepting under favorable conditions, I direct my said Executors to hold and manage such remaining portion of my residuary estate until in their judgment it can from time to time be advantageously sold and disposed of, not exceeding however a period longer than the lives of my sons, Marshall Orme Wilson and Richard T. Wilson, Jr., and the survivor of them, and I hereby authorize and empower my said executors within said period, to sell, convey, assign and transfer the same, or any part thereof, at such time or times as they may deem for the best interests of my estate, and upon such terms and conditions as they may deem proper, including the terms and mode of payment therefor * * *." (R. 30, fol. 65).

The will then provided that:

> "Upon any sale or disposition being made by my said executors of such portion of my residuary estate, or of any part thereof, or of the shares of the corporation which they are hereinbefore authorized to incorporate, or any part thereof, I authorize and empower my said executors, if the proceeds, or any part thereof, may in their judgment be distributed among the persons entitled thereto hereunder without any detriment to their interests to so distribute them forthwith; or in their discretion to retain the same, or any part thereof, for further conversion before distribution, not, however, beyond the period of the lives of my said sons ant the survivor of them.
>
> "During the period that my said executors shall hold such portion of my residuary estate or the shares of the corporation which they are hereinbefore authorized to incorporate, or any

> part thereof, they shall semi-annually pay over the net income thereof, or of such parts thereof as may be unsold or undistributed, to the persons to whom my residuary estate is bequeathed in and by the foregoing fourth article in the proportion of their respective interests." (R. 30-31, fols. 66-67).

These provisions contemplate the holding of the residuary property by the executors for advantageous sale, the distribution of all income in the meantime to the residuary legatees and the prompt distribution of the proceeds of sale, unless requiring further conversion. They do not contemplate reinvestment of the proceeds of sales if received in form suitable for distribution, as they contain no powers or directions as to reinvestments, but only provisions for "further conversion before distribution." In contrast to this, detailed powers as to reinvestment are given the trustee of the express trusts (R. 31, fol. 68).

Although these powers are limited in duration to two lives in being, there is no gift over of any remainder interests at the termination of such lives, the entire interest in the residue (except for the additions to the express trusts) being given to the five children absolutely by Article Fourth of the will. Although power to receive the rents and profits is essential to the existence of a valid trust, (Sec. 97 New York Real Property Law) the will does not expressly give such a power to the executors.

The will also gave the executors a power (never used, R. 35, fol. 76) of putting portions of the residuary estate in a corporation and holding the stock until it could be advantageously sold (R. 30, fol. 65).

Both courts below held that a trust of the residuary estate must be implied but that the taxpayer was nevertheless entitled to a deduction. The District Court

allowed the full deduction of $22,660 claimed (R. 36). The Circuit Court of Appeals held that the taxpayer was entitled to deduct a part of the loss proportionate to the part of the selling price distributed to him in 1922, and reversed for new trial. If it appears on such trial that the $50,000 distributed in 1922 was part of the selling price of the Commercial Building, the taxpayer will be entitled under that decision to deduct one-fifth of 50,000/165,000 of the loss of $113,300 or $6,866.66 (R. 53).

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

1. In holding that the will of Richard T. Wilson, Sr., created a trust with respect to his remaining residuary estate.

2. In not holding that, even though a trust was created with respect to the remaining residuary estate, the taxpayer was entitled to deduct from his income his full share of the loss on the sale of the Commercial Building.

3. In reversing the judgment of the District Court.

Summary of Argument.

The taxpayer is entitled to deduct from 1922 income his share of the loss on the sale of the Commercial Building because he was for every practical purpose the owner of a one-fifth interest in this property. The loss is deductible under section 214 (a) (5), Revenue Act of 1921, allowing individuals to deduct losses incurred in transactions entered into for profit, which clearly applies to losses on the sale of inherited property of a business or investment character.

Even if there was a technical trust of the residuary estate of Richard T. Wilson, Sr., including this property, which we deny, such trust was one to sell and distribute the proceeds, the termination of which would not change any beneficial interest in the property; it was a trust in which the beneficiaries were vested with complete ownership of every present and future interest in the property, were entitled to the distribution of all the income and were taxable thereon, and were entitled to distribution of the proceeds of all sales either forthwith or after further conversion by the executors. Such beneficiaries acquired their interests in such trust upon the death of Richard T. Wilson, Sr., were enriched by the value of the property at that time (*Brewster* v. *Gage*, 280 U. S. 327) and actually sustained the loss when the property was later sold for a smaller amount. This position is supported by *Merle-Smith* v. *Commissioner*, 42 F. (2d) 837, certiorari denied 282 U. S. 897, where the beneficiary of a trust, entitled to 75% of the net income and to the corpus at a specified age, was allowed a deduction for depletion of the mining property held in trust because the court regarded the beneficiary as the real owner of the trust property and the person who suffered the depletion.

The cases of *Abell* v. *Tait*, 30 F. (2d) 54, certiorari denied 279 U. S. 849, and *Baltzell* v. *Mitchell*, 3 F. (2d) 428, certiorari denied 268 U. S. 690, and any cases involving beneficiaries having only life interests, are not inconsistent in principle with the taxpayer's contention. In those cases the beneficiaries could never personally receive any of the corpus, having only life interests, or could personally receive the corpus only if they survived at the termination of specified lives. Such beneficiaries had no immediate interest in the corpus and were not personally affected by losses or gains on the sales of the corpus. In the case at bar, however, the benefici-

aries personally owned every interest in the corpus, their possession was not necessarily postponed until any one's death, and losses or gains on sales of the corpus directly affected the amounts distributable to them forthwith or after further conversion by the executors. The vital distinction between cases where the present beneficiary had every beneficial interest in the property and cases where the remaindermen were others than the present beneficiaries was early noted by the Bureau of Internal Revenue in O. 1013, 2 CB 181, 186 (1920) and has been given effect by the Board of Tax Appeals and the Courts.

The fact that section 219 of the Revenue Act of 1921 makes estates and trusts separate taxpayers under certain circumstances is not decisive because trusts, the entire income of which is distributable, are not taxpayers, such income being taxable to the beneficiary. In such cases, particularly where every present and future interest in the property is vested in the beneficiaries, the statute requiring each beneficiary to pay income tax on his distributive share of the income of the estate or trust (section 219 (d)) should be construed to permit him to deduct his share of any net loss of the estate or trust, just as the similar statute with respect to partnerships (section 218) is so construed. Articles 345 and 332, Regulations 62; *People ex rel., Field* v. *Gilchrist,* 240 N. Y. 301. The assertion in *Busch* v. *Commissioner,* 50 F. (2d) 800 that Section 219 of the Revenue Act of 1921, makes every fiduciary a taxpayer, is not sound as applied to trusts falling within paragraph (4) of Section 219 (a).

In fact, no trust of the residuary estate of Richard T. Wilson, Sr., was created; the five children became the legal, as well as the beneficial, owners of the residuary real estate, subject to a power of sale in the executors, and may deduct the loss on the sale of their

property. The testator did not intend to create any trusts, other than those expressly provided for, and gave the proceeds of the residuary estate to his five children to be theirs absolutely. No trust is necessarily implied from the powers given the executors to hold and manage the residuary estate pending sale, to distribute the income and, in their discretion, to retain proceeds of sale for further conversion or create a holding corporation. Any implied power to receive the rents and profits was not one of the objects and purposes of the will but merely incidental to the power of sale and hence no valid trust was created, but merely a power of sale. Section 97, New York Real Property Law; *Brooklyn Trust Company* v. *Kernan*, 108 Misc. (New York) 452, affirmed 191 App. Div. 895.

If the taxpayer is not entitled to deduct his full share of the loss, he is at least entitled to deduct a part of such loss proportionate to the part of the proceeds of the sale actually distributed to him in 1922, as the Circuit Court of Appeals held. If the property had been sold at a gain and his share of the gain had been distributed to him he would have been taxable on the gain. (Section 219 (d)). If the property had been distributed to him in kind and sold by him the same amount of loss or gain would have been reflected in his personal return (*Brewster* v. *Gage*, 280 U. S. 327). To the extent that the taxpayer actually received in 1922 part of the proceeds of a sale of the corpus, the loss attributable to such proceeds should be deductible by him just as distributed gains would be taxable to him. His capital investment in the property, that is its value when acquired by inheritance, should be taken into account in his return to the extent that the proceeds of a sale are actually distributed to him in that year, whether the sale resulted in a loss or gain. Cf. concurring opinion in *Merle-Smith* v. *Commissioner*, 42 F. (2d) 837.

ARGUMENT.

I.

The five children of Richard T. Wilson, Sr., became the owners of his residuary real estate at his death and the taxpayer was entitled to deduct his share of the loss resulting from the sale of part of such real estate in 1922.

The taxpayer claims the right to deduct one-fifth of the admitted loss on the sale in 1922 of the six-story office building in New York City, known as the Commercial Building, on the ground that he was for every practical purpose the owner of a one-fifth interest in such building and personally sustained such loss.

The deduction is claimed under section 214(a) (5) of the Revenue Act of 1921 (see Appendix, page 32) as a loss incurred in a transaction entered into for profit. It is clear that losses on the sale of inherited business property are deductible under this provision. *Brewster* v. *Gage*, 280 U. S. 327 (1930). Section 202 (a) (3) of the Revenue Act of 1921 specifically provides the basis for loss or gain on the sale of property acquired by inheritance. This undoubtedly was intended to apply in cases of losses by individuals on the sale of inherited property of an investment or business character, such as stocks, bonds, and business real estate. The Bureau of Internal Revenue and the Board of Tax Appeals have always allowed such losses to be deducted. *T. B. R. 35*, 1. C. B. 122 (1919); *G. C. M. 6811*, IX-1 C. B. 136; *Altmayer* v. *Commissioner*, 10 B. T. A. 1091. In *Heiner* v. *Tindle*, 276 U. S. 582, this court gave a broad construction to the phrase "in any transaction entered into for profit" and stated that the right to deduct losses on sales of inherited property under this pro-

vision was not questioned. Controversy has arisen only where the inherited property may have been acquired for personal use as in the case of a residence. *Appeal of Williams,* 1 B. T. A. 1101. The Commercial Building, here in question, was business property producing rental income distributable to and taxable to the five children.

The only question is whether the taxpayer's interest in this property was sufficiently direct and complete to entitle him to deduct the loss from his individual income. If, as we maintain, the taxpayer was the substantial owner of a one-fifth interest in the Commercial Building, his inherited capital, acquired upon his father's death, was invested in the building and he suffered a loss when the building was later sold for a smaller amount, and, as is generally true with respect to inherited property of a business or investment character, such loss is deductible by him as a loss sustained in a transaction entered into for profit. The contention that the taxpayer had no interest in the Commercial Building because the executors were directed to sell it and distribute the proceeds to the five children is wholly inconsistent with the actual situation. All of the debts had been paid, and the five children had every real interest in the few assets remaining in the residuary estate. A similar contention was rejected by the court in *Brewster* v. *Gage,* 280 U. S. 327.

(a) *Any trust of the remaining residuary estate created by the will of Richard T. Wilson, Sr., was a trust to sell and distribute in which the beneficiaries had such direct and complete ownership of the corpus that they were entitled to deduct from their individual incomes losses sustained on the sale of such corpus.*

Assuming, contrary to our contention (see p. 24 below) that a trust of the residuary estate was created, it was one to sell and distribute the proceeds, the bene-

ficiaries had the direct and complete ownership of the corpus, were entitled to current distribution of all of the net income and of the proceeds of all sales immediately or after further conversion by the executors. In such a trust, the losses sustained on the sale of trust assets are actually sustained by the beneficiaries and are deductible by them under Section 214(a) (5) Revenue Act of 1921. The District Court so held. (R. 44).

The decisive consideration is that the five beneficiaries of the trust, if one existed, personally owned every present and future interest in the trust property and its income. There were no other remaindermen, contingent or otherwise. Their ownership was vested, complete and exclusive. Their posession was not postponed until the termination of any life. Most of the original corpus had already been distributed to them, partly in cash and partly in securities. They acquired their interests on the death of Richard T. Wilson, Sr., and were then enriched by the value of the property. (*Brewster* v. *Gage, supra.*) Any loss on the sale of the corpus was a direct loss to them, and directly affected the amounts distributable to them forthwith or after further conversion by the executors. The income, being currently distributable, was taxable to them under sections 219(a) (4) and 219(d) of the Revenue Act of 1921 (see appendix, pages 32 and 33). The beneficiaries possessed every substantial attribute of ownership and the losses suffered on the sale of the corpus were their losses, the entire burden of which fell directly upon them.

Direct support for the taxpayer's position is found in *Merle-Smith* v. *Commissioner,* 42 F. (2d) 837, certiorari denied 282 U. S. 897, where the Circuit Court of Appeals for the Second Circuit sustained the right of trust beneficiaries receiving royalties, to

a deduction for depletion of the mining property held in the trust. In that case the beneficiary was entitled to receive 75% of the net annual income of the trust, and to receive the corpus when she reached the age of 45 years, with power to dispose of the property by will in case of earlier death. The Court allowed the beneficiary depletion with respect to the trust property on the ground that she was the real owner of such property. The Court said:

> "The petitioner here has the real interest in the corpus. She possesses every important attribute of ownership. She has a 75% interest in the income and she suffers most by the depletion. Apart from the payments to others of a 25% interest while they live during the period of the trust she is in the position of one having others manage her property."

This decision is generally followed and is accepted by the government.

> *Alphin* v. *Commissioner*, 21 B. T. A. 1101.
> *Kuhn* v. *Commissioner*, 24 B. T. A. 216.
> *Cooper* v. *Reynolds*, 60 F. (2d) 650.
> *G. C. M. 10273*, Internal Revenue Cumulative Bulletin, XI-11, p. 3.
> Cf. *Commissioner* v. *Molter*, 60 F. (2d) 498.

This decision can not be distinguished on the ground that it involved a deduction for depletion rather than a deduction for losses. In *United States* v. *Ludey*, 274 U. S. 295 (1927), the Court treated the exhaustion of mining property or the wearing-out of a plant as a gradual sale of the property and indicated that the theory underlying the allowance for depletion and depreciation is the same as the theory allowing cost to be applied against the selling price in the case of a sale. Depletion is allowed under the

statute to the person who suffers depletion of his property, (section 214(a) (10) Revenue Act of 1921) just as losses are allowed to the persons who suffer losses on the sale of their property. (Section 214(a) (5) Revenue Act of 1921.) Neither deduction could be allowed to a taxpayer who had no interest in the property subject to depletion or loss.

In the case at bar the five children possessed every important attribute of ownership of the trust property. They were directly interested in all of the income and all of the proceeds of sale and they sustained the loss in question. The *Merle-Smith* case shows that that existence of the trust is no bar to the recognition of these facts.

Decisions of the Board of Tax Appeals recognizing the right of beneficiaries of a trust to deduct losses, depreciation or depletion with respect to trust property, where the beneficiaries were also remaindermen and the termination of the trust would not affect the beneficial ownership of the property, are as follows:

Appeal of Julia N. DeForest, 4 B. T. A. 1059.
Munger v. *Commissioner*, 16 B. T. A. 168.
Francis v. *Commissioner*, 15 B. T. A. 1332.
Alphin v. *Commissioner*, 21 B. T. A. 1101.
Arrott v. *Commissioner*, 23 B. T. A. 478, 488.

The cases of *Abell* v. *Tait*, 30 F. (2d) 54 (C. C. A. 4th, certiorari denied 279 U. S. 849), and *Baltzell* v. *Mitchell*, 3 F. (2d) 428 (C. C. A. 1st, certiorari denied 268 U. S. 690), are not inconsistent in principle with the taxpayer's contention. In neither of those cases could the proceeds of sales be distributed to the beneficiaries prior to the termination of specified lives. In *Baltzell* v. *Mitchell*, *supra*, the property had to be held in trust until the deaths of the beneficiaries there involved. In *Abell* v. *Tait*, *supra*, as appears from the

copy of the will set forth in *Elizabeth M. Abell, et al.*, 4 B. T. A. 87, the property had to be held in trust until the death of Elizabeth Maxwell Abell, the wife; the daughter's share, if she survived, was to be held in trust for her life; and the two sons would personally receive a share of the corpus only if they survived their mother. In those cases the beneficiaries had no immediate interest in the corpus of the trust, the amount of income or distributions which they received was not affected by losses or gains on the sale of trust assets, and they were not substantially the present owners of the trust properties. It was for this reason that it was held in those cases that the life beneficiaries of the trusts were not entitled to deduct losses on the sale of trust assets. Thus in *Baltzell* v. *Mitchell, supra,* the Court said:

> "The beneficiary is not interested in the capital of the trust, but only in the income. If there are accretions to the capital, these are not distributable as income, so that the beneficiary may receive any part of them; and if there are capital losses they can not be made good out of the income. The capital may be depleted by such losses; but the income for that taxable year is not. It may in future years be diminished because of the diminution of the capital."

In *Abell* v. *Tait, supra,* the Court said:

> "The amount actually distributed to the beneficiaries could not have included any part of the capital of the trust estate for any such distribution would have been contrary to the express provisions of the trust."

Even though Mrs. Baltzell had an equitable vested remainder and the two sons of Mr. Abell would receive shares in the corpus if they survived their mother, it is nevertheless true in both the *Baltzell*

and *Abell* cases that the beneficiaries had no immediate interest in the corpus, and that no part of the corpus could be distributed until the end of the designated lives.

The other cases cited by the Solicitor General in his petition for certiorari in No. 460 at pages 14 and 15* all involved life beneficiaries, having no personal interest in the remainder. In all of those cases it was clear that the beneficiary could never receive any distributions of corpus. In these cases the Courts relied very strongly on the fact that they were dealing with life beneficiaries having no interest in the remainder.

The disinction between this line of cases and the present case is clearly pointed out in *Merle-Smith* v. *Commissioner, supra,* where the court distinguishes *Baltzell* v. *Mitchell,* as follows:

> "In the *Baltzell* case, *supra,* Mrs. Baltzell had 'a vested equitable remainder,' which was a power to dispose of the property by her will; she had no legal remainder. At bar the trust is not for life, for it ends at the forty-fifth birthday of the petitioner Kate Fowler Merle-Smith. Margaret Fowler's ceases at the same time or sooner in the event of the death of Kate Fowler Merle-Smith. The petitioner here has the real interest in the corpus. She possesses every important attribute of ownership."

In the same case the court distinguishes *Roxburghe* v. *U. S.,* 64 Ct. of Cl. 223, as follows:

> "In *Roxburghe* v. *United States,* 64 Ct. of Cl. 223, the plaintiff was merely a beneficiary entitled only to income of the trust created for her life. She had no interest in the corpus."

**Roxburghe* v. *United States,* 64 Ct. of Cls. 223, certiorari denied 278 U. S. 598; *Whitcomb* v. *Blair,* 25 F. (2d) 528; *Codman* v. *Miles,* 28 F. (2d) 823 certiorari denied 278 U. S. 654; *Hubbell* v. *Burnet,* 46 F. (2d) 446, certiorari denied 283 U. S. 840; *Codman* v. *Commissioner,* 50 F. (2d) 763; *Roxburghe* v. *Burnet,* 58 F. (2d) 693, certiorari denied 286 U. S. 567; *Kaufmann* v. *Commissioner,* 44 F. (2d) 144.

The Board of Tax Appeals has likewise recognized the vital distinction between a case in which the beneficiary has an interest in the corpus and a case in which the beneficiary has only an interest in the income. See *Falk, et al., executors* v. *Commissioner,* 24 B. T. A. 299, 303.

This basic distinction was clearly recognized by the Bureau of Internal Revenue in the early ruling made in *O. 1013,* 2 C. B. page 181 (1920). In that case the Solicitor of Internal Revenue in Case III at page 184, held that life beneficiaries could not deduct from their distributive share of the net income of a trust, losses on the sale of corpus because the burden of such losses did not fall on the life tenants, but on the remaindermen. At page 186, however, the Solicitor says:

> "This reasoning is not applicable where the estate or trust does not represent different interests and is susceptible of treatment as a unit. So property left in trust for an incompetent, or *property left in trust in which the present beneficiary has the entire beneficial interest,* could at least in cases (II), (III) and (IV) be treated as a unit *and should be so treated.*" (Italics supplied).

Since case III referred to was the case of losses on the sale of corpus, this is a clear holding that a beneficiary of a trust who has the entire beneficial interest in the corpus should be allowed the benefit of losses on the sale of corpus, which is the taxpayers position in this case. This ruling recognized that such a beneficiary is on the same basis as an incompetent whose property is held by trustees or a ward whose property is held by a guardian, that the beneficiary is the real taxpayer and the real owner of the property in such a case and hence entitled to the benefit of losses on the sale of his property. In view of

this ruling it cannot be maintained that there has been a consistent administrative practice denying the benefit of losses of corpus to a beneficiary of a trust who has the entire beneficial interest in the property held in trust.

The simple fact is that a life beneficiary does not bear or sustain the loss on a sale of the corpus because it does not affect the income distributable to him, but primarily affects the remainderman. Hence in many cases the Bureau of Internal Revenue and the Courts have denied such deductions to a life beneficiary. But where the present beneficiary is also the remainderman he does directly bear the loss and it does affect him. This vital difference has not always been clearly recognized, but it is a substantial fact which should not be disregarded. This fact makes the life beneficiary cases wholly inapplicable.

The present case does not involve life beneficiaries. Here, the beneficiaries beneficially owned every present and future interest in the trust property, its income and proceeds of sales. The amounts distributed to the beneficiaries could and did include distributions of corpus and gains on the sale of corpus, most of the corpus had already been distributed, and the executors could have distributed the entire remaining corpus in that year.

The question is not settled by general statements that trusts are separate taxpaying entities under Section 219 of the Revenue Act of 1921. It is true that under Section 219 many trusts are taxpayers separate and distinct from the beneficiaries. This is true of an estate in process of administration, where the income is not currently distributable (paragraph 1), where the beneficiary of a trust is unborn or unascertained or has a contingent interest (paragraph 2) or where the income is held for future distribution (paragraph 3). *This is not true, however, where all of the in-*

come of an estate or trust is to be distributed to the beneficiaries periodically (*paragraph 4*). In such cases where the owner of the income is definitely known, the fiduciary is not made a taxable entity. In such cases the fiduciary is not a taxpayer and all the income is taxable to the beneficiaries (Section 219(d)). Such fiduciaries are put on the same basis as a guardian of an infant, they merely represent a definite, ascertained, present owner. This is recognized by Article 345 of Regulations 62, which provides among other things:

> "The regulations governing partnerships are generally applicable to such an estate or trust."

Partnerships of course are not separate taxpayers under the Revenue Act of 1921 (Section 218). In this class of cases the fiduciary merely files an information return for the purpose of showing the income taxable to the beneficiary. If such a return shows a net loss, the beneficiary should be allowed to deduct his share of such loss, just as a partner is allowed to deduct his share of a partnership loss (Article 332, Regulations 62) although the statute with respect to partnerships is silent as to losses (Section 219). In the case at bar the will specifically provides in Article Fifth (R. 31, fol. 67) that the executors shall "semi-annually pay over the net income thereof, or of such parts thereof as may be unsold or undistributed, to the persons to whom my residuary estate is bequeathed." And even the proceeds of sales are to be distributed unless the executors decide in their discretion to retain the same or a part thereof for further conversion. In 1922, although the executors' expenses exceeded their income, they nevertheless distributed $50,000. (R. 34). There were no undistributed gains. In 1922 this trust was not a taxpayer or a taxable entity.

This view is squarely supported by the decision in *People ex rel. Field* v. *Gilchrist*, 240 N. Y. 301 (1925), in which the New York income tax law, very similar in its provisions to the federal income tax law, was construed to permit the beneficiary of a trust to deduct from her personal income real estate taxes paid by the trustee on trust property, such taxes being paid out of trust income exempt from tax. The court recognized that in such a case the burden of the tax fell on the beneficiary and that a refusal to allow such deduction to the beneficiary would be "a straining of the law to read into it a meaning inconsistent with reality." The court relied on the state regulations, which followed the federal regulations in providing that the regulations as to partnerships should apply to trusts, where the income was periodically distributable.

The decision in *Busch* v. *Commissioner*, 50 F. (2d) 800 completely disregards the fact that the statute does not make a trust falling under paragraph (4) of Section 219(a) (in which all the income is distributable to the beneficiaries), a separate taxpayer. In such a trust "the tax shall not be paid by the fiduciary" but only by the beneficiary (Section 219(d)). This provision is wholly comparable to the provision that "individuals carrying on business in partnership shall be liable for income tax only in their individual capacity" (Section 218). Such a trust is no more a taxable entity than is a partnership. The broad assertion that Section 219 makes estates and trusts separate taxpayers, is not sound as applied to cases falling within paragraph (4) of Section 219(a).

The result may be different where the trust is not one to sell and distribute the proceeds and where there is a difference in the immediate interests in current income and in the losses and gains on the sale of corpus. But in a case such as this, where there is no diversity

of interest and the beneficiaries are to receive personally both the income and the proceeds of sales, the existence of the trust should not have the effect of denying to the beneficiaries the losses which they have actually sustained, any more than the existence of the trust in the *Merle-Smith* case had the effect of denying to the beneficiary of the trust a depletion deduction which she had actually suffered.

This court has recognized that the technical existence of a trust should not serve to obscure the facts. In *Lederer* v. *Stockton* (1922) 260 U. S. 3, a charitable corporation had the remainder interest in a trust which had not yet fallen in because one annuitant was still living. The trustee loaned the corpus to the charitable corporation in return for a sufficient amount of interest to pay the remaining annuity and the expenses of the trust. The government claimed that the trustee was subject to income tax on the income of the corpus of the trust but the court refused to reach this technical result, recognized that, nothwithsanding he legal existence of the trust, the charitable corporation in fact received the income, which in its hands was exempt from tax, and held that no tax was due from the trustee. It said:

> "To allow the technical formality of the trust, which does not prevent the Hospital from really enjoying the income, would be to defeat the beneficent purpose of Congress."

In like manner here, to allow the technical formality of the trust, which does not prevent the beneficiaries from really suffering the loss on the sale of property, to defeat their right to the deduction, would be to defeat the express intent of Congress to permit individuals to deduct losses sustained by them.

(b) *There was in fact no trust of the residuary real estate so that the taxpayer was the legal, as well as beneficial owner of a one-fifth interest in the property sold.*

The questions discussed above arise only on the basis that the property sold was held in trust and are discussed first because both lower courts held that a trust must be implied.

The taxpayer maintains that the will of Richard T. Wilson, Sr., did not in fact create a trust of the residuary real estate. The five children therefore were vested with the legal title to such property, subject only to a power of sale in the executors. The loss sustained on the sale of their property was consequently deductible by them.

The structure of the will of Richard T. Wilson, Sr., clearly shows that the draftsman did not intend to create any trust of the residuary estate and the testator's intent is, of course, the determining factor in construing a will. *Colton* v. *Colton*, 127 U. S. 300, 309.

The will created trusts of $500,000 each for each of the five children, which were bequeathed to the Union Trust Company of New York as trustee, provided for increasing three of these express trusts by an additional $500,000 out of the residuary estate and gave the balance of the residuary estate (with which we are here concerned) to the five children absolutely. (Articles Third and Fourth of the will, R. 28-29). There was no devise or bequest of such property to the executors, as trustees or otherwise, there was no gift over of a remainder after life estates, there was merely an absolute gift of the proceeds of such property to the five children.

The absolute interest thus given to the children should not be cut down by implying a devise in trust to the executors as trustees, since there are no ex-

press words creating such a trust and no such trust results by clear and undoubted implication from other provisions of the will. *Freeman* v. *Coit*, 96 N. Y. 63, 68; *Beaver* v. *Beaver*, 117 N. Y. 421, 428; *Post* v. *Hover*, 33 N. Y. 593, 599.

The property which the testator desired to withhold from the immediate ownership and possession of the children through trusts was the property bequeathed in trust to the Union Trust Company of New York, which is referred to in Article Sixth of the will "as trustee of the trusts hereinbefore created" (R. 31, fol. 68) and in Article Ninth of the will "as trustee of the trusts under this will." (R. 32, fol. 70.) Article Sixth, furthermore, specifically provides the powers which such trustee shall have with respect to holding and making investments but the will is silent with respect to the character of any investments by the executors. Such a trust would be valid under Sections 96 and 97 of the Real Property Law of New York only if the trustee was empowered to receive the rents and profits, but the draftsman of the will gave no express power to the executors to receive the rents and profits of the residuary real estate.

The powers given to the executors to deal with the residuary estate pending its sale or distribution are not such as to require the conclusion that a trust of the residuary estate must be implied.

The testator recognized that his executors should be given ample time within which to make an advantageous sale of his residuary estate which would consist to a large extent of real estate and stocks in business corporations. He therefore directed the executors to "hold and manage" such residuary estate until it could be advantageously sold, gave them power to form a holding corporation if desirable,

directed them to sell and distribute the proceeds of sales among the five children, with discretion to retain such proceeds for further conversion before distribution and in the meantime to distribute the income "to the persons to whom my residuary estate is bequeathed."

Under the New York law a mandatory direction to executors to sell the property and distribute the proceeds does not create a trust, where no power to receive the rents and profits is given. *Matter of Callahan,* 96 Misc. 74, affirmed 176 App. Div. 906, affirmed 200 N. Y. 59.

The only provision of the New York Real Property Law under which such a trust of real estate could be valid would be subdivision 2 of Section 96 authorizing a trust "to sell, mortgage or lease real property for the benefit of annuitants or other legatees," but by Section 97 of the Real Property Law it is provided

> "A devise of real property to an executor or other trustee for the purpose of sale or mortgage, where the trustee is not also empowered to receive the rent and profits, shall not vest any estate in him; but the trust shall be valid as a power, and the real property shall descend to the heirs or pass to the devisees of the testator, subject to the execution of the power."

The New York courts have construed these provisions as authorizing the existence of a trust only where the power to receive the rents and profits is one of the objects and purposes of the trust and not merely incidental to the main purpose of sale and distribution. In *Brooklyn Trust Company* v. *Kernan,* 108 Misc. 452, affirmed 191 App. Div. 895, the property was devised to the executors in trust to sell and convert into cash and distribute the proceeds and in

the meantime to take charge of the property and receive and distribute the rents. The court held that these provisions did not create a trust because no trust was intended, as the testator intended his beneficiaries to have the property without waiting for any contingency. The express power to collect the rents was regarded as merely incidental to the power of sale. The same result was reached as to the remainder estate considered in *Ray* v. *Fowler*, 200 App. Div. 155. See also *Heermans* v. *Burt*, 78 N. Y. 259; *Henderson* v. *Henderson*, 113 N. Y. 1.

In the case of *Morse* v. *Morse*, 85 N. Y. 53, upon which the District Court relied in holding that there was a trust of the residuary estate in this case (R. 44) the court found, under very similar testamentary provisions, that the creation of a trust of the residuary estate in that case was intended. But in that case the residue consisted largely of a single 150-acre farm which the legatees were seeking to partition with threatened destruction of values and the court concluded that this was the very thing which the testator intended to prevent. In the present case the residue consisted of a large amount of securities and numerous parcels of real estate in various localities. There is no question of the technical right to partition of real estate and the intention of the testator to avoid creating a trust of his residuary estate is clear. The judges in the *Kernan* case and *Ray* v. *Fowler* did not regard their decisions as contrary to *Morse* v. *Morse*. In the *Kernan* case the court said:

> "It may be that citations are of little value on this point for decisions seemingly quite at variance to those just referred to can be found. *Morse* v. *Morse*, 85 N. Y. 53; *Hubbard* v. *Houseley*, 43 App. Div. 129. As has been already stated the question in each case is one of intention."

The fact that the draftsman of the will limited the executors' power of sale to two lives in being is not significant as this limitation is not peculiar to trusts, but may apply, or at least might be thought to apply, to powers in trust. *Chaplin on Suspension of the Power of Alienation,* 3rd Ed. p. 244; see *Matter of Butterfield,* 133 N. Y. 473.

The power given to the executors in case the property was sold to retain the proceeds "for further conversion before distribution" can not be construed as an authority to the executors to retain and reinvest and hold proceeds received in a form suitable for distribution. This is clear from the fact that the will contains no provisions as to the making of investments by the executors. This power applied solely to cases such as the sale of real estate subject to a mortgage where it might be detrimental to their interests to attempt to distribute the mortgage among the five children.

All of the objects and purposes of the testator could be properly carried out through powers in trust. It is not necessary to imply a trust of the residuary estate contrary to his intention and repugnant to his absolute gift to his children.

There being no trust, but merely a power of sale in trust, legal title to the real estate vested in the five children at the death of Richard T. Wilson, Sr., Section 97, New York Real Property Law; *Brewster* v. *Gage,* 280 U. S. 327, and the loss on the sale of the Commercial Building is deductible by the five owners in equal shares.

II.

The taxpayer is at least entitled to deduct for 1922 a part of the loss on the sale of the Commercial Building proportionate to the part of the proceeds of such sale distributed to him in that year, as the Circuit Court of Appeals held.

The Circuit Court of Appeals adopted the practical view that the right to deduct the loss on the sale of the Commercial Building should follow the proceeds of the sale, that is, should remain with the executors to the extent that the proceeds were retained, but should be allowed to the beneficiaries to the extent that the proceeds were distributed to them during the year.

The court pointed out that if the property had been sold at a profit, the profit would be taxed to the executors if retained by them (Section 219 (a) (3) and 219 (c)) and to the beneficiaries if distributed to them (Section 219 (a) (4) and Section 219 (d)). Notwithstanding the discretionary power of the executors to retain the proceeds for further conversion, and the provisions of Article 342 of Regulations 62, it is clear that income, including capital gains, properly distributed would be taxable to the distributees. *Lehmann* v. *Commissioner,* 21 B. T. A. 664, 673; *Barton* v. *Commissioner,* 5 B. T. A. 1008, affirmed 26 F. (2d) 765; *Elizabeth F. Sprague,* 8 B. T. A. 173, *Willcuts* v. *Ordway,* 19 F. (2d) 917; *Crocker* v. *Nichols,* 27 F. (2d) 598.

To the extent that the proceeds were actually distributed, the court recognized that the capital resulting from the sale was the taxpayer's individual capital, which he had acquired at the testator's death (*Brewster* v. *Gage, supra*) and which by reason of the distribu-

tion was in his actual possession in 1922, and that the loss sustained with respect to such captial should be allowed as a deduction from the taxpayer's 1922 income just as the gain with respect to such capital if distributed would have been taxed to him.

This result is a logical conclusion from the reasoning of Judge A. N. Hand in his concurring opinion in *Merle-Smith* v. *Commissioner,* 42 Fed. 2d. 837. Judge Hand concurred in the view that the beneficiaries of the trust should be allowed depletion with respect to the trust properties, not because they had a direct interest in the corpus which would soon come into possession, but because the royalties which they received included capital to the extent of the depletion. Since the beneficiaries were receiving the full proceeds of the sale of part of the mineral, he held that they should receive the benefit of the deduction for the cost of the mineral sold. This would usually be less, but might be more, than the royalties. So in this case, to the extent that the beneficiaries received the proceeds of any sales, they should get the benefit of the capital investment applying against such sales. They would get such benefit where the property was sold at a profit since they would be taxed only on the profit and they should get the same treatment where the property was sold at a loss.

If the property had been distributed to the beneficiaries in kind and they had sold it at a loss, they would, of course, have been entitled to deduct as a loss the difference between the selling price and the value at date of acquisition, which was the value at the date of the testator's death. (*Brewster* v. *Gage, supra; Estate of Frances Abeles,* 24 B. T. A. 435; *Marian B. Pringle,* 26 B. T. A. 362.) Why should not the same result follow where the executors sell and distribute the proceeds, at least in proportion to the

proceeds distributed? It certainly makes no practical difference whether the sale is made by the executors and the proceeds distributed, or the property is distributed and sold by the beneficiaries. The loss is just as real and just as personal to the beneficiaries in the one case as in the other.

This principle clearly applies to trusts such as the one at bar where the beneficiaries own every interest in the property, and are entitled not only to current income, but also to distributions of corpus. In such cases, there can be no objection to recognizing the complete ownership of trust property by the beneficiary and the loss actually sustained by him, at least to the extent that the property or its proceeds actually comes into his possession during the taxable year.

CONCLUSION.

The decision of the Circuit Court of Appeals should be reversed and the decision of the District Court affirmed. In the alternative, the decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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APPENDIX.

Section 214 of the Revenue Act of 1921, 42 Stat. 239, provides:

> "Sec. 214. (a) That in computing net income there shall be allowed as deductions:
>
> * * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *."

Section 219, Revenue Act of 1921, 42 Stat. 246, provides:

> "Sec. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—
>
> (1) Income received by estates of deceased persons during the period of administration or settlement of the estate;
>
> (2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;
>
> (3) Income held for future distribution under the terms of the will or trust; and
>
> (4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.
>
> (b) The fiduciary shall be responsible for making the return of income for the estate or trust

for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, * * *. In cases in which there is any income of the class described in paragraph (4) of subdivision (a) of this section the fiduciary shall include in the return a statement of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to each beneficiary, whether or not distributed before the close of the taxable year for which the return is made.

(c) In cases under paragraphs (1), (2), or (3) of subdivision (a) or in any other case within subdivision (a) of this section except paragraph (4) thereof the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir, or other beneficiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, or, if his taxable year is different from that of the estate or trust, then there shall be included in

computing his net income his distributive share of the income of the estate or trust for its taxable year ending within the taxable year of the beneficiary. In such cases the beneficiary shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust.

(e) In the case of an estate or trust the income of which consists both of income of the class described in paragraph (4) of subdivision (a) of this section and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with subdivision (b) and the tax shall be imposed, and shall be paid by the fiduciary in accordance with subdivision (c), except that there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in paragraph (4) of subdivision (a) which, pursuant to the instrument or order governing the distribution, is distributable during its taxable year to the beneficiaries. In cases under this subdivision there shall be included, as provided in subdivision (d) of this section, in computing the net income of each beneficiary, that part of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable during the taxable year to such beneficiary."

Section 96 of the New York Real Property Law provides:

"*Purposes for which express trusts may be created.* An express trust may be created for one or more of the following purposes:

1. To sell real property for the benefit of creditors;

2. To sell, mortgage or lease real property for the benefit of annuitants or other legatees, or for the purpose of satisfying any charge thereon;

3. To receive the rents and profits of real property, and apply them to the use of any person, during the life of that person or for any shorter term, subject to the provisions of law relating thereto;

4. To receive the rents and profits of real property, and to accumulate the same for the purposes, and within the limits, prescribed by law."

Section 97 of the New York Real Property Law provides:

"*Certain devises to be deemed powers.* A devise of real property to an executor or other trustee, for the purpose of sale or mortgage, where the trustee is not also empowered to receive the rents and profits, shall not vest any estate in him; but the trust shall be valid as a power, and the real property shall descend to the heirs, or pass to the devisees of the testator, subject to the execution of the power."